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Central Intelligence Bulletin

State Dept. review completed

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March 22, 1974

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March 22, 1974

Central Intelligence Bulletin

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EC - ARAB STATES: Virtually no progress has been made toward opening an EC-Arab dialogue; both sides are wrestling with internal conflicts.

Washington's displeasure with the EC Nine's decision to seek a cooperation agreement with the Arabs has had a dampening effect. The attitude of the new British Government, which is still reviewing its foreign policy options, is also causing delay.

The British reserved their position when the EC announced its policy of cooperation with the Arabs on March 4; the Labor government has not yet made a decision. In a parliamentary debate, Foreign Minister Callaghan declared he favors EC negotiations with the Arabs, but advocates a deliberate approach. Callaghan professed that London would insist on EC consultations with the US prior to any final decision.

The continued embargo of Arab oil to the Netherlands and restrictions on oil deliveries to Denmark may also slow progress on the EC side. The Dutch foreign minister has emphasized that The Hague will not support cooperation with the Arab states if the Arabs persist in their embargo. Dutch officials have reportedly agreed, however, not to block preparatory talks. Denmark remains on the Arab "neutral" list. The Danes are wary of trying to block the opening of a dialogue with the Arabs and seem to be counting on Dutch opposition to slow things down.

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The EC already has established special relations with many of the Arab countries. The EC has preferential trade agreements with four Arab countries in the Mediterranean basin and is currently negotiating with three others. This policy provides for financial aid in the form of soft loans to less-developed Arab states. [redacted] 25X1

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EGYPT: The Egyptian Army is demobilizing some of its reserves who were called up for the October war. According to [redacted] the US Embassy in Cairo, the reservists will be released in two groups, the first on March 16 and the second a month later.

[redacted]

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The releasing of reservists from active duty would be in line with what appears to be a generally relaxed posture of the Egyptian military. [redacted]

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CAMBODIA: Sihanouk's "prime minister" Penn Nouth has made more comments on Khmer Communist attitudes toward negotiations, indicating that he wanted his remarks relayed to the US Government. In discussions last week with the French ambassador to Peking, Penn Nouth stressed that there can be no political dealings with the Lon Nol government and that "US efforts" to create such a dialogue are in vain. According to Nouth, talks between Sihanouk's "government" and the US are the only possible form of negotiations, and if the US does not respond, the war will continue for "as long as necessary." Nouth warned that prolonging the conflict will serve to enhance the Khmer Communists' political power at the expense of "moderates" like himself and Sihanouk.

Sihanouk himself revived the subject of talks between his "government" and the US in a speech delivered in Laos on March 12. The idea of direct talks with Washington--by-passing the Lon Nol government--was a standard feature of Sihanouk's line on negotiations until early last summer when the possibility of a US bombing halt grew stronger.

Although Sihanouk may now be signaling a new willingness to talk with the US, there have been no signs that Khmer Communist leaders in Cambodia are ready to consider a compromise settlement with the government in Phnom Penh. In the most recent restatement of the insurgents' hard-line position, a senior Khmer Communist official in Paris ruled out any negotiations leading to a coalition government or a territorial division of the country. He also said that there could be no "third force" solution for Cambodia and took some pains to proclaim the Khmer Communists' independence from their allies.

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*HUNGARY: A major shake-up in the top Hungarian party leadership has weakened the political position of party chief Janos Kadar and dealt a major setback to Budapest's liberal economic and cultural policies. The changes, announced at a party plenum late yesterday, indicate that Kadar has acceded to pressures for increased orthodoxy both from Moscow and from Hungarian conservatives. The communiqué on the plenum indicates that similar changes are being made throughout the party's central apparatus.

The key victims of the shake-up were party secretaries Rezso Nyers and Gyorgy Aczel, who were removed from their daily control of economics and culture, respectively. They had become symbols of Kadar's cautiously liberal domestic policies. Although both men retain their seats on the Politburo, their demotions and other personnel changes leave no doubt that Hungarian policy will now take on a more rigid, orthodox cast.

Nyers' important economic duties apparently will go to Budapest party leader Karoly Nemeth, who has proved much more willing to compromise some of the principles of the economic reform program. Politburo member Lajos Feher, a vocal advocate of reform and a popular champion of agricultural interests, was prematurely retired. The party official responsible for daily supervision of the military and security organs was also replaced, suggesting that some laxities had developed in these sensitive areas.

Although Kadar's position has been weakened, it is too early to write his political obituary. He is very adept at balancing competing political interests and has not hesitated to back away from liberalism in the past. In late 1972, for example, he parried strong pressures for more orthodoxy with adroit compromises that seemed to answer the demands of his critics.

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It is clear, however, that Soviet demands for orthodoxy were not satisfied. Kadar's decision to chair the commission that will draft a new party program indicates that he is determined to weather the current setback and to limit the damage.

Reactions from the Hungarian populace will vary. Agriculture's interests clearly have suffered with the removal of Feher, and any popular outbursts may well come from the peasantry. The moves will cause extreme concern among intellectuals and the substantial number of technocrats whose careers are linked to the economic reform. [redacted] 25X1

*Because of the shortage of time for preparation of this item, the analytic interpretation presented here has been produced by the Central Intelligence Agency without the participation of the Bureau of Intelligence and Research, Department of State.

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<u>WEST GERMANY - USSR</u>: A West German delegation arrived in Moscow yesterday to complete the final arrangements for the joint Soviet-German iron-steel project at Kursk. West German Ambassador Sahm expected the signing of the contract to take place yesterday, but no official statement to this effect has been made.

According to Sahm, the two-month deadlock concerning financial arrangements for the deal was broken when the Soviets offered a considerable compromise. Sahm said party leader Brezhnev sent a personal message to Chancellor Brandt stating that the Soviets will pay nearly $800 million in cash for the first phase of the Kursk project. Brezhnev proposed that the second phase be financed on a "compensatory" basis, with the West Germans providing credits to be repaid in kind from the plant's production. Previously, the Soviets had been seeking West German credits to finance the entire project.

West German foreign policy adviser Egon Bahr recently spent 11 days in Moscow, during which time he had at least two long conversations with Brezhnev. The two discussed the Kursk project and may have arranged the compromise deal at that time. [redacted] 25X1

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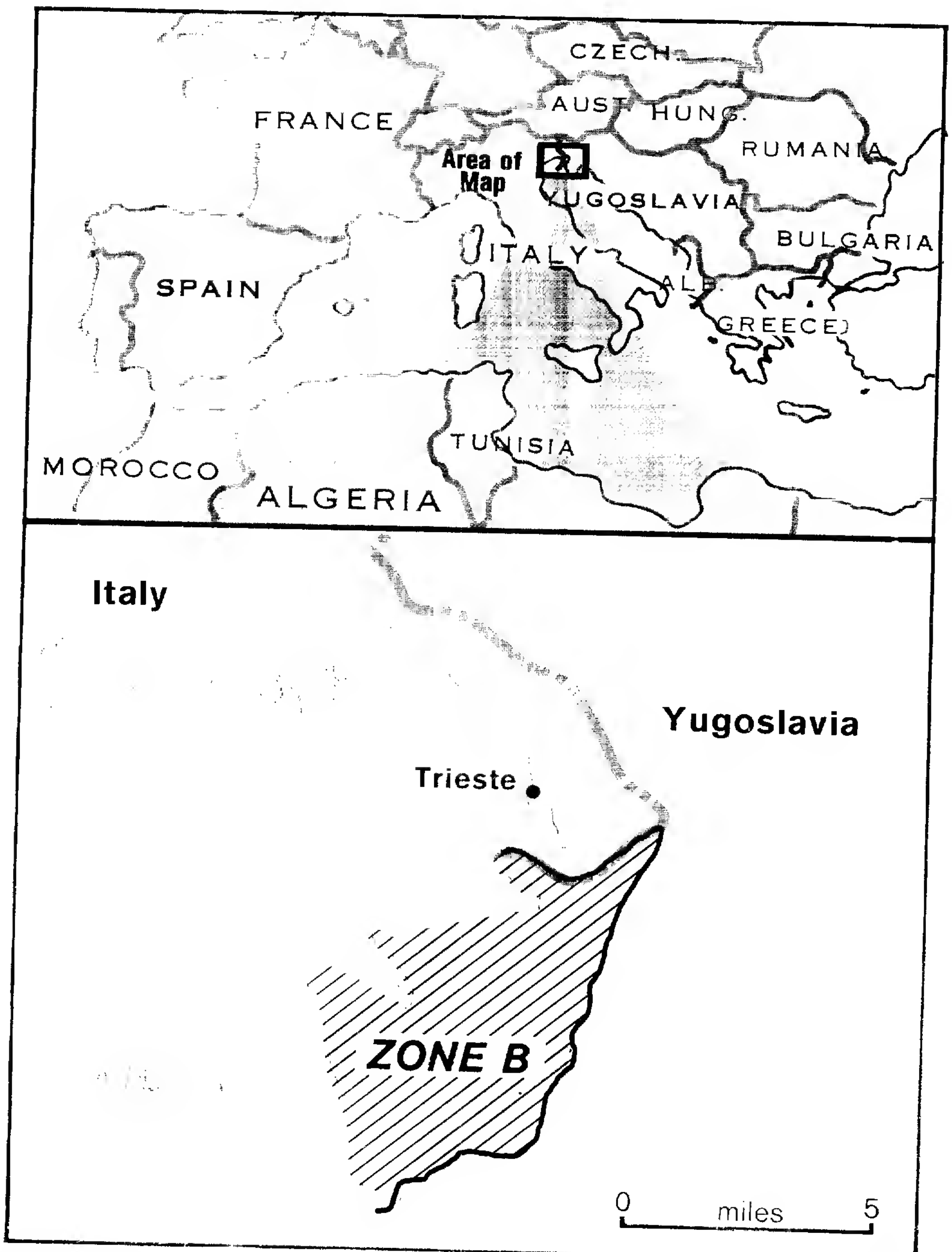
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YUGOSLAVIA-ITALY: Belgrade's reaction to the current dispute with Rome over Yugoslav sovereignty in "Zone B" south of Trieste will probably continue to be noisy and sharply worded. Tito is not expected to compromise, because this might encourage other neighbors to raise similar irredentist claims.

Yugoslavia administers "Zone B" under the terms of the London memorandum of understanding in 1954. Although Yugoslavia and Italy are both parties to the memorandum, there has not been a final settlement on the border issue. Since the end of World War II, Italian rightists, who are particularly strong in the Trieste area, have blocked Rome from acceding to Belgrade's demands for official Italian recognition of Yugoslav jurisdiction over "Zone B." In recent years, however, the Italians have been able to give Belgrade private assurances that no renewed claims would be made.

The Italians seemingly broke this pattern when, in an unpublicized note of mid-January protesting Yugoslavia's posting of border signs in "Zone B," they reminded Belgrade that it does not have full sovereignty over what Rome considers Italian territory. At that time the government probably felt compelled to respond to the Yugoslav action in order to undercut neo-fascist grandstanding in Parliament and to avoid further strains on a tenuous coalition.

The mid-January note was subsequently recalled, but Rome renewed its claim with a new note on March 11. Belgrade then made the quarrel public by issuing its own diplomatic protest and opening a propaganda barrage against Italy.

Rome apparently did not intend the incident to go so far and now wants to soften the exchange. Premier Rumor stated before Parliament yesterday that the "territorial integrity of the Yugoslav Republic" was not and would not be questioned, and he expressed the wish that relations between the two countries

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could develop in a friendly manner. The Italians apparently have not, however, fully withdrawn their territorial claim to "Zone B". On Wednesday, as Rome prepared its next move, the Yugoslav Government strongly denounced the Italian position. Belgrade put the onus on Italy for "crushing" good bilateral relations and warned that Yugoslavia "knows how to defend its territory."

For Tito, the problems posed by the "Zone B" controversy extend beyond the immediate issue. Irredentism is an unpleasant backdrop to his efforts to ensure a smooth succession, and he must believe he cannot tolerate Rome's claims to "Zone B" without inviting similar problems, especially with Bulgaria. Although it does not make any direct claims to Yugoslav territory, Sofia steadfastly asserts that citizens of Yugoslavia's Macedonian Republic are Bulgarian by nationality. The Yugoslavs have recently been extremely defensive about the Bulgarian position, which now threatens the development of improved bilateral relations.

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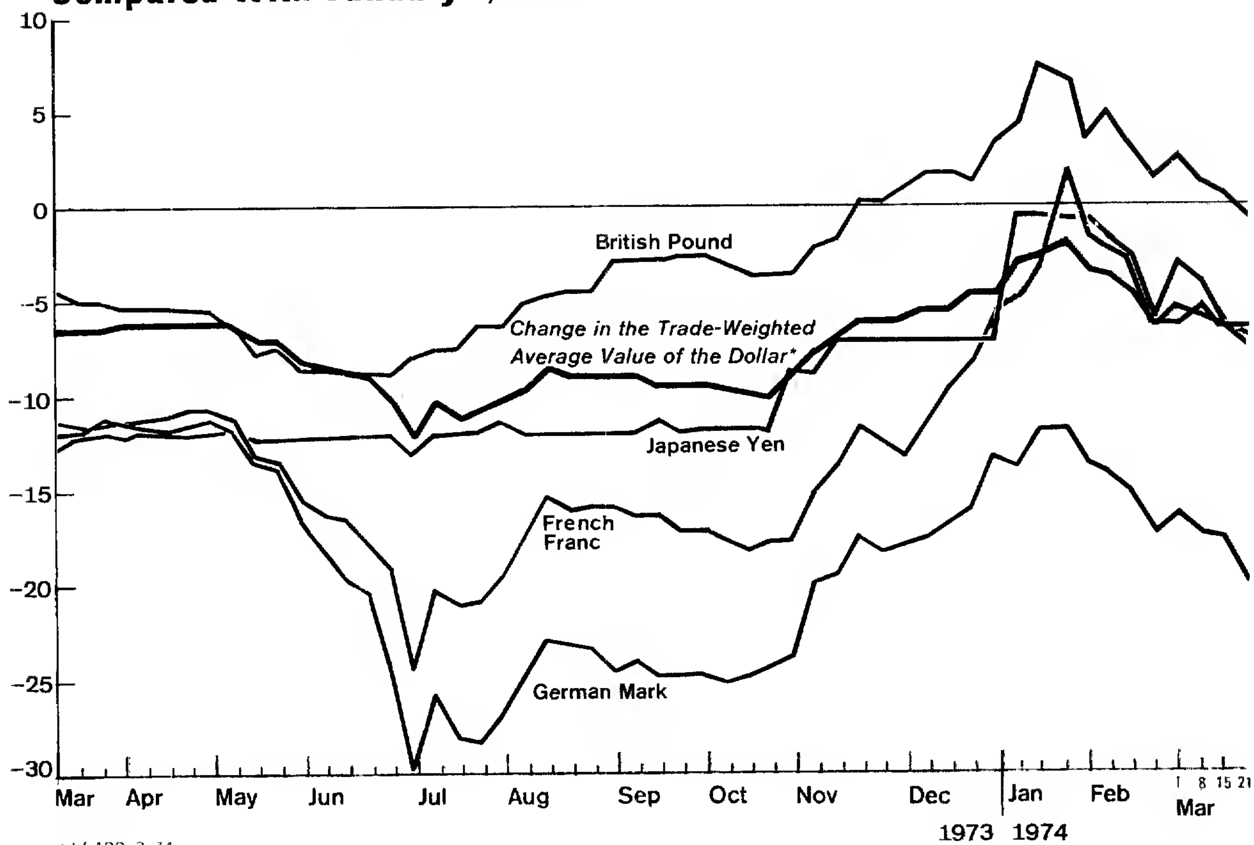
ITALY: Tacitly acknowledging the failure of selective price and credit controls to dampen Italy's record-breaking inflation, the Bank of Italy has raised the basic discount rate to 9 percent--a postwar high. In recent months, industrial demand for credit has been greater than its availability, leading to a steady rise in commercial interest rates and sharply increased demands for advances from the central bank.

The new move is designed to bring domestic rates more in line with those prevailing in other EC countries. The government hopes that higher rates for short-term credits will reduce borrowing for speculating in currency and limit the inflationary growth of domestic credit.

The higher rates also will aid Italy's sharply deteriorating balance-of-payments position by encouraging private borrowing abroad, by reducing the incentive to export capital in search of better rates, and by making it too expensive for firms to continue hoarding imported goods as a hedge against further devaluation of the lira. Foreign banks may, however, be unwilling to lend to Italian borrowers because of heightened economic uncertainties, thereby limiting some of the hoped-for benefits of higher interest rates. [redacted]

Percent Change In the Value of the US Dollar Relative to Selected Foreign Currencies Compared With January 2, 1973



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INTERNATIONAL MONETARY DEVELOPMENTS: The dollar continued to drop sharply in major European markets yesterday. Intense demand for the mark, coupled with the French and Italian decisions to terminate their two-tier currency systems, brought the dollar to its lowest level since mid-November.

The dollar's greatest losses were recorded against the mark, which rose almost 3 percent over the past two days. The mark is now at its highest level since early November. The demand for marks surged Wednesday following release of a report by the Hamburg Institute for Economic Research stressing the need for a German revaluation if present oil prices persist.

The institute's report, together with recent official statements on the desirability of further strengthening the mark, renewed speculation that revaluation would occur soon. Official German denials of any revaluation plans coupled with Bundesbank intervention--$50 million was purchased yesterday--helped prevent even further weakening of the dollar.

Substantial dollar losses in the past two days were also recorded against all other major European currencies. The guilder gained over 2.5 percent, while the other currencies reported gains of well over 1 percent. Currency uncertainty also increased speculative interest in gold. The price rose seven dollars Wednesday to $176 per ounce before easing slightly yesterday to $175 an ounce.

Decisions by Paris and Rome to terminate their two-tier systems--which separate financial and commercial foreign exchange markets--added to the present currency uncertainty, thus strengthening the shift from dollars. The French system, established in 1971, was set up to protect its fixed rate from speculative pressures and to preserve official reserves. The two French rates have merged recently, making a dual system meaningless.

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The Italian system was introduced to help limit capital movements out of the country and to ease pressures on reserve holdings. Rome's decision to abandon the two-tier system indicates that it was ineffective in protecting the lira. Rome has wanted to harmonize its exchange rate system with the rest of Europe, and the French move afforded an excellent opportunity to terminate the cumbersome system.

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OIL DOLLARS: Middle East oil producers are investing substantial sums in long-term bonds issued by the World Bank. Iran's first such purchase--$200 million worth of 12-year bonds--will be approved within days.

A Kuwaiti bond purchase of $84 million in November brought its holdings of World Bank bonds to over $400 million. Libya bought $101 million worth last August. With the Iranian purchase, the share of World Bank debt held by Middle East oil producers will have risen from about 5 percent to 10 percent in the past seven months.

World Bank investment teams are currently visiting all Middle East oil producers in an attempt to sell additional bonds. Other countries, especially Saudi Arabia, almost certainly will subscribe to future issues.

Long-term offerings by the World Bank have only recently been of interest to most Middle East investors, who traditionally have favored highly liquid, short-term securities. The bonds are attractive to the Arabs now because they are secure from being frozen in retaliation for Middle East oil policies. The bonds not only provide a competitive rate of interest, but will also help the oil producers meet the obligation they feel to make more funds available to developing nations.

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FOR THE RECORD

<u>Iraq-Czechoslovakia</u>: Iraq has recently received 16 new L-29 jet trainer aircraft from Czechoslovakia. Baghdad took delivery of 40 L-29s during the late 1960s, and most of them are still in service. In December 1972, Baghdad ordered 50 Czech L-39 supersonic jet trainers, the successor aircraft to the L-29; delivery of these aircraft was scheduled to begin in 1973, but production problems have delayed shipments.

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<u>Haiti</u>: President Duvalier has dropped two prominent old-guard Duvalierists from his cabinet--Foreign Minister Adrien Raymond and Minister of Interior and Defense Breton Nazaire. The President is apparently continuing a campaign started last August to replace corrupt politicians with younger and more honest technical experts.

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